PEPSI-COLA
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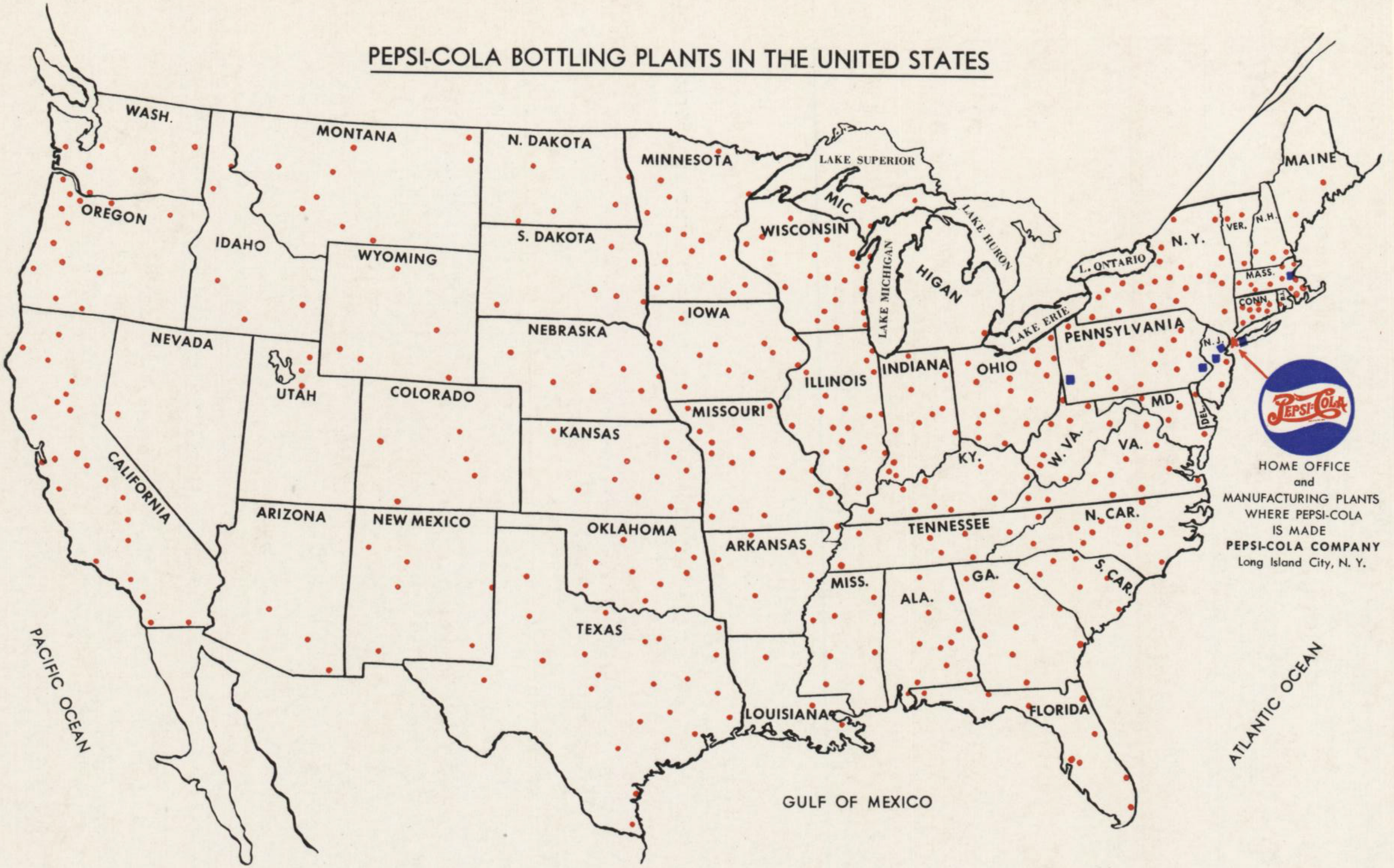
PEPSI-COLA COMPANY

ANNUAL REPORT

1940

PEPSI-COLA BOTTLING PLANTS IN THE UNITED STATES



• Authorized Franchise Bottlers

■ Wholly-owned Subsidiary Bottling Plants

THE 1940 ANNUAL REPORT

OF

THE PEPSI-COLA COMPANY

March 10, 1941

To Our Stockholders:

The year 1940 was a year of continued progress in the affairs of Pepsi-Cola Company. To meet the constantly increasing demand for its product, the capacity of both your Company's plants and those owned by franchise bottlers were expanded; additional franchise bottlers were secured; co-operative activities designed to improve production methods and to strengthen sales efforts of the franchise bottlers were intensified. New advertising material and media, improved both from the point of attractiveness and of public appeal, were adopted. A new, distinctive and uniform bottle was introduced.

As a result of increased effectiveness in practically every phase of the Company's operations, sales increased in a most encouraging fashion, and the net operating profits before Federal and Canadian income taxes show an increase reflecting this growth of your business. The results of the work done during 1940 and the developing of our franchise bottlers should be reflected in the progress of the Company in the years to come.

SALES

Sales of the Pepsi-Cola Company have continued to show a steady increase in all territories. In the United States the percentage increase of 1940 sales over 1939 was approximately 42%. There was a substantial increase in sales in Canada, South America and Central America.

FINANCIAL REVIEW

There is presented herewith a review of the operations of your Company and Subsidiaries for the year 1940, together with a Consolidated Balance Sheet at December 31, 1940, and a Summary of Consolidated Income and Earned Surplus for the year then ended, certified by Haskins & Sells, independent certified public accountants.

OPERATING NET PROFIT

The consolidated operating net profit after all charges and expenses, but before deduction of Federal and Canadian income taxes was $8,520,582.31 compared with $5,952,602.39 on the same basis for the year 1939. This shows an improvement of approximately 43% in operating net profit before Federal and Canadian income taxes as compared with the previous year. A comparison on this basis (that is, before income taxes but after all other charges) is made because it presents the best means by which you may judge the progress of your Company, because the increase in 1940 of normal income taxes and the 1940 Excess Profits Tax, both in the United States and Canada, did not exist in the previous year. It is also appropriate to point out that this increase of approximately 43% in operating net profit has been obtained despite substantial increases in advertising, sales promotion and other expenses in 1940 as compared with similar expenditures in 1939, and despite deduction for losses incurred in the disposal of certain old equipment, and in the change to the new uniform, standard bottle in all Company-owned plants.

Below you will find the operating net profit for each of the years since 1936, after deducting all charges and expenses, but before deduction of Federal and Canadian income taxes:

1936	$2,083,597.57
1937	3,224,625.72
1938	4,027,513.92
1939	5,952,602.39
1940	8,520,582.31

NET INCOME AFTER ALL TAXES

After providing for all income taxes and excess profits taxes in the United States and Canada—the net income of your Company for the year 1940 was $5,821,853.26 or $22.45 per share of outstanding stock as compared to a net income of $4,870,478.82 or $18.78 per share for the year 1939.

During the year 1940, your Company paid dividends aggregating $18.00 per share, or a total of $4,666,986.00 as compared to a dividend of $15.00 per share, aggregating $3,889,155.00, paid in 1939.

COMPANY-OWNED PLANTS AND EQUIPMENT

The Company-owned plants and equipment are all in good condition. Improvements of and additions to equipment have been made from time to time during the year, both to improve the operating effectiveness of the plants and to enable your Company to maintain a capacity adequate to care for the constant growth in sales. Among the major improvements and additions in this respect during the year 1940 were the following:

(a) The East River bottling plant has been enlarged to provide for constantly increasing sales in the Metropolitan New York area. This expansion was completed and paid for in the year 1940 and resulted in substantial improvement in facilities for manufacturing and distribution.

(b) A new syrup storage tank for the sugar refinery, with a capacity of 1,400,000 gallons, was erected and put into operation at the East River plant. This has enabled the sugar refinery to operate more economically.

(c) The old and inadequate boiler house and equipment in the East River plant has been replaced with a modern and efficient boiler house and power plant, all without interruption in the operation of the plant.

(d) At Boston, the Company has erected and put into operation, through a wholly-owned subsidiary, a new and modern bottling plant, and has set up a new sales and distributing organization in that territory. This meets a long-felt want and should contribute materially to sales efforts in New England.

(e) A new Pepsi-Cola bottle of distinctive design with the name "Pepsi-Cola" molded into the glass of the bottle, has been developed and introduced. This new bottle is now exclusively used in all company-owned plants, and is gradually being introduced in the plants of franchise bottlers.

(f) An improved Pepsi-Cola bottle cooler for retail store use was designed and put on the market. This new stream-lined distinctive cooler has been engineered to occupy less space while providing increased cooling and storage facilities.

FRANCHISE BOTTLERS

Throughout the year special effort has been devoted to strengthening the status of the franchise bottlers. A map showing the distribution of our bottlers in the United States is shown on the back of the front cover of this report. The num-

ber of your Company's franchise bottlers in the United States has increased during the year from 400 to 415. Of equal importance is the fact that there has been a substantial strengthening of the existing franchise bottler situation which should in time be reflected in greater sales within the territories of these bottlers.

Your Company has greatly increased its cooperative efforts to aid and stimulate the operations of its franchise bottlers. Manufacturing processes employed by the franchise bottlers have been surveyed and suggestions for improvement have been made in many cases. Assistance has been given in the development of promotional and advertising methods. Sales training schools and conventions have been held in different sections of the United States. New and improved advertising material has been made available to the franchise bottlers. A considerably expanded appropriation for advertising in cooperation with franchise bottlers has proved markedly successful.

As a result of increasingly effective teamwork and heightened confidence on the part of franchise bottlers in the present management of and future outlook for the company, your franchise bottlers have thrown themselves into the development of the business with increased enthusiasm and effectiveness, evidenced particularly by larger expenditures for new and additional equipment and plant improvements. It is estimated that during the year 1940, the expenditures of franchise bottlers for new equipment and plant improvements aggregated in the neighborhood of $6,800,000,—a very substantial increase over 1939.

There are still a few territories in the United States not yet franchised and a number of territories which have to be strengthened and your management is giving constant attention to that situation.

SUPPLIES

The stockholders will be pleased to know that the Company is covered on all of its ingredients and materials for the year 1941, so that there should be no major change in basic costs. In fact the Company has on hand supplies of some of its materials, such as cola nuts and sugar, etc., sufficient to last for a much longer period.

SCOPE OF PEPSI-COLA OPERATIONS

The Annual Report for the year 1939 covered in some detail the location and equipment of the Company's plants and the development of its operations in the United States and in other countries. It does not appear appropriate to repeat this information in the present report; instead, copy of the 1939 report will be sent to any stockholder upon request.

MERGER PLANS

A plan for the merger of your Company with Loft Incorporated was submitted last autumn to the stockholders of both companies. As you were previously advised, although a large majority of stockholders of both companies favored the plan, it was necessary to abandon it because of the tax problems presented.

Officers of your Company and of Loft Incorporated have recently been working on a new and different plan of merger. If the tax and other problems connected with this plan can be worked out satisfactorily, it is expected that this new plan of merger will be submitted to the stockholders in the near future for consideration.

MOVING FORWARD

While much progress has already been made in strengthening all phases of the activities of your Company and of its franchise bottlers, an immense amount of work still remains to be done. For the year 1941, sales methods and sales promotion materials are being further improved; the advertising program will be somewhat increased and better rounded out. The home carton containing six bottles, which was first introduced in a substantial way in 1940, and met with a very favorable reception, will be further pushed in 1941.

In order to meet the growing demands in the Philadelphia area, a new plant is now being equipped and will be completed before the summer season. This new plant will very substantially increase the production capacity in Philadelphia, and will show more economical production costs.

For the franchise bottlers, a sales and service school and training course will again be conducted. Efforts will be made to encourage bottlers to change over as completely as possible to the use of the new distinctive Pepsi-Cola bottle; sales in certain relatively unsatisfactory franchise territories will be analyzed carefully and steps taken to see that distribution in these areas is brought up as rapidly as possible to a higher level.

It is apparent from the foregoing report that progress has been made during the past year, but much still remains to be done. The year 1940 saw the strengthening of the whole Pepsi-Cola group, which should be reflected in the years ahead.

Your officers and directors look forward with confidence to the continued expansion and success of your Company.

By Order of the Board of Directors,

Walter S. Mack, Jr.
President

PEPSI-COLA

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CONSOLIDATED BALANCE

ASSETS

CURRENT ASSETS:			
Cash		$2,401,426.54	
Notes receivable (less reserve of $25,150.00)		134,160.38	
Accounts receivable (less reserve of $22,170.68)		187,142.12	
Marketable securities—at cost (quoted market value, $44,819.78)		44,707.16	
Inventories (see Note A):			
Finished and in-process inventories	$ 397,611.99		
Raw materials and supplies	3,204,198.29	3,601,810.28	
Total current assets			$6,369,246.48
MISCELLANEOUS ASSETS:			
Notes and accounts receivable—not current (less reserve of $30,500.00)		$ 230,395.78	
Machinery held for resale		33,454.81	
Other		21,136.47	
Total miscellaneous assets			284,987.06
INVESTMENTS:			
Capital stock of Loft Incorporated—11,700 shares at cost (quoted market value $204,750.00)		$ 23,400.00	
Investment in and advances to wholly-owned British subsidiary (less reserve)		121,209.90	
Other		8,515.15	
Total investments			153,125.05
PROPERTY:			
Land, buildings and equipment (at cost less reserve for depreciation, $802,701.15)		$4,727,765.43	
Bottles and cases on hand and with trade (at values as determined by officials of the companies which in the aggregate are less than cost)		819,604.13	
Total property			5,547,369.56
TRADE-MARKS, FORMULAS AND GOODWILL (at value determined by the Directors of the Company in 1931, representing the par value of 300,000 shares of capital stock issued therefor, of which 100,000 shares were donated back to the Company)			1,500,000.00
DEFERRED DEBIT ITEMS:			
Prepaid insurance and taxes		$ 311,547.14	
Advertising materials		101,525.07	
Other		55,203.57	
Total deferred debit items			468,275.78
TOTAL			$14,323,003.93

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l in Delaware)

SIDIARIES

British Subsidiary)

SHEET, DECEMBER 31, 1940

LIABILITIES

Current Liabilities:		
Accounts payable	$ 400,210.42	
Accrued liabilities:		
United States and Canadian income and excess profits taxes—estimated.	2,694,387.11	
Other taxes	190,287.13	
Miscellaneous	170,223.54	
Total current liabilities (exclusive of customers' deposits on bottles and cases as stated in next item below)		$3,455,108.20
Customers' Deposits on Bottles and Cases		395,437.29
Capital Stock and Capital Surplus:		
Capital stock:		
Authorized and issued, 300,000 shares of $5.00 par value each	$1,500,000.00	
Less in treasury—40,723 shares	203,615.00	
Outstanding—259,277 shares	$1,296,385.00	
Capital surplus:		
Par value, $500,000.00, of 100,000 shares of Company's stock donated to the Company, less discount of $250,713.51 upon sale of 62,500 shares of such stock, plus net discount of $2,962.00 on 1,014 shares of Company's stock purchased	252,248.49	
Amount received from Loft Incorporated in connection with settlement of litigation	250,000.00	
Total capital stock and capital surplus		1,798,633.49
Earned Surplus		8,673,824.95

The notes on the next pages following, including the references to contingent liabilities, are an integral part of the above statement and should be considered in connection therewith.

Total	$14,323,003.93

PEPSI-COLA COMPANY AND SUBSIDIARIES

(Other Than The British Subsidiary)

NOTES TO CONSOLIDATED BALANCE SHEET

DECEMBER 31, 1940

A. The inventories are stated on the basis of average cost. In accordance with the accounting procedure followed by the companies, raw materials and supplies are charged to operations on the basis of average purchase cost, without recognition in the income account of any market declines since such declines are ordinarily without effect upon the stabilized sales prices of their products. During the year 1940 a reserve was provided out of surplus (for purposes of conservative treatment in the balance sheet) for market decline of sugar, but this reserve was reversed at December 31, 1940 inasmuch as the quoted market value of sugar at that date was in excess of cost.

B. Foreign subsidiaries:

The assets and liabilities of the Canadian and Cuban subsidiaries are included in the consolidated balance sheet on the following basis: The current assets and liabilities of the Canadian subsidiary have been converted into U. S. dollars at the Canadian official rate of exchange, and those of the Cuban subsidiary at the current rate of exchange, at December 31, 1940; their other assets and liabilities have been included at amounts which reflect their U. S. dollar equivalent at the time of acquisition or origin. The assets of the Canadian subsidiary, amounting to approximately 9% of the consolidated total, are subject to the presently prevailing Canadian exchange restrictions.

Inasmuch as the disturbed conditions prevailing in Europe make it impossible to estimate what the ultimate effect will be upon the property and business interests of the British subsidiary, the assets and liabilities of such subsidiary have not been included in the consolidated balance sheet. However, the deficit of the British subsidiary at December 31, 1940 has been fully provided for on the books of the parent company and the amount at which the investment in and advances to this subsidiary are shown represents the net equity in the British subsidiary converted into U. S. dollars on the same basis as used for the Canadian subsidiary.

C. The companies have contingent liabilities as of December 31, 1940 as follows:

(1) Contingent liability arising out of the use of its trade-mark in connection with the manufacture, sale and distribution of its product in the United States and foreign countries.

(2) Pending litigation involving the use of the "Pepsi-Cola" trade-mark:

(a) A suit for an injunction and an accounting was brought by Coca-Cola Company of Canada, Limited, against Pepsi-Cola Company of Canada, Limited (a wholly-owned subsidiary of the Company), charg-

ing infringement of the alleged "Coca-Cola" trade-mark, in which a decision, on appeal, was rendered in favor of Pepsi-Cola Company of Canada, Limited, by the Supreme Court of Canada on December 9, 1939. The Coca-Cola Company of Canada, Limited was granted leave to appeal to the Privy Council of the House of Lords, London and Pepsi-Cola Company of Canada, Limited was granted leave on its cross-appeal in December, 1940. As of the date hereof, such appeals have not been heard by Privy Council.

(b) The Company instituted a suit in the Supreme Court of the State of New York, County of Queens, against The Coca-Cola Company, seeking damages and injunctive relief restraining The Coca-Cola Company from engaging in certain alleged monopolistic and unfair business practices and activities. The Coca-Cola Company has filed an answer in this suit, consisting of a general denial and an affirmative defense and counterclaim in which The Coca-Cola Company charges that the trade-mark "Pepsi-Cola" infringes its mark "Coca-Cola", and unfair competition, and seeks injunctive relief as well as an accounting by this Company for treble damages and profits. The Company has filed a reply to said counterclaim, consisting of a general denial and various affirmative defenses. The action is still pending undetermined in the Supreme Court of the State of New York, Queens County.

(c) Litigations and registration proceedings involving the registration of the Pepsi-Cola trade-mark in various foreign countries.

(3) Federal income tax returns of the companies have been examined through the year 1937, and settlements effected (subject to approval of Treasury Department officials in Washington) for all years examined. Returns for the years 1938 and 1939 are in process of examination. A report has not been received from the examining agent, but he has indicated to officials of the companies that the propriety of certain deductions claimed in those years is questionable. In the event that the items in question are disallowed, the companies would be subject to additional Federal income taxes of approximately $200,000.00. Officials of the companies do not agree with the contentions of the examining agents.

(4) A claim for approximately $127,500.00 for alleged services claimed to have been rendered for and in behalf of Pepsi-Cola Company, which is pending in the Superior Court of Delaware.

(5) Various other claims and litigations against Pepsi-Cola Company and its subsidiaries involving a total sum not in excess of $125,000.00.

The Company admits no liability in connection with the above contingent liabilities and no provision for loss in connection therewith has been made in the accompanying statements.

PEPSI-COLA COMPANY AND SUBSIDIARIES

(Other Than The British Subsidiary)

SUMMARY OF CONSOLIDATED INCOME AND EARNED SURPLUS FOR THE YEAR ENDED DECEMBER 31, 1940

Gross Profit on Sales		$16,295,934.38
Advertising, Selling, General and Administrative Expenses		7,737,226.71
Profit From Operations		$ 8,558,707.67
Other Income		66,795.40
Gross Income		$ 8,625,503.07
Other Charges		104,920.76
Net Income Before Deducting Provision For Income and Excess Profits Taxes		$ 8,520,582.31
Provision For Income and Excess Profits Taxes (estimated):		
United States normal income taxes	$1,850,000.00	
United States excess profits taxes	600,000.00	
Canadian income and excess profits taxes, and other income taxes	248,729.05	2,698,729.05
Net Income		$ 5,821,853.26
Earned Surplus, January 1, 1940		7,518,957.69
Total		$13,340,810.95
Dividends Paid		4,666,986.00
Earned Surplus, December 31, 1940		$ 8,673,824.95

Notes:

1. The income and expenses of the Canadian subsidiary have been converted into U. S. dollars at the Canadian official rate of exchange prevailing during the year and those of the Cuban subsidiary at the current rate of exchange, except as to provision for depreciation which has been converted for both subsidiaries at rates prevailing at time of acquisition of the related assets.

2. The provision for depreciation which was charged to manufacturing and other expense accounts for the year 1940, amounted to $329,069.60.

HASKINS & SELLS
CERTIFIED PUBLIC ACCOUNTANTS

67 BROAD STREET
NEW YORK

ACCOUNTANTS' CERTIFICATE

PEPSI-COLA COMPANY:

We have examined the consolidated balance sheet of Pepsi-Cola Company and its subsidiaries (other than the British subsidiary) as of December 31, 1940 and the related summary of consolidated income and earned surplus for the year ended that date, have reviewed the systems of internal control and the accounting procedures and have examined or tested the accounting records and other supporting evidence of such companies (other than the Canadian subsidiary) by methods and to the extent we deemed appropriate. As to the Canadian subsidiary, we have examined a report of chartered accountants, and the figures included in the accompanying statements with respect to this subsidiary are derived from such report. The total assets of this subsidiary amount to approximately 9% of the consolidated total, and its gross profit on sales and net income for the year were approximately 7% and 6%, respectively, of the consolidated totals. The accounts of the British subsidiary have been examined by us for the year 1940, but have not been included in the consolidated statements as explained in Note B to the consolidated balance sheet.

In our opinion, which as to the Canadian subsidiary is based upon reports of other accountants as above mentioned, the accompanying consolidated balance sheet and the related summary of consolidated income and earned surplus, with the footnotes thereon, fairly present the financial condition of the companies at December 31, 1940 and the results of their operations for the year ended that date, in conformity with generally accepted accounting principles followed by the companies on a basis consistent with that of the preceding year.

HASKINS & SELLS

New York,
March 10, 1941.

DIRECTORS

Frank P. Burns	Walter S. Mack, Jr.
James W. Carkner	Herman Shulman
Edward A. Le Roy, Jr.	Harral S. Tenney

Arthur T. Vanderbilt

OFFICERS

Walter S. Mack, Jr.	*President*
Don G. Mitchell	*Vice-President*
J. Willard Pipes	*Vice-President*
George M. O'Neil	*Vice-President*
Phillip C. Crowen	*Vice-President*
Talbot O. Freeman	*Vice-President*
Milward W. Martin	*Secretary*
Joseph A. Murphy	*Treasurer*
Thomas E. O'Callaghan	*Asst. Secretary*
G. Edward Harwood	*Asst. Treasurer*

AUDITORS

Haskins & Sells
Certified Public Accountants

TRANSFER AGENT

The Marine Midland Trust Company of New York
120 Broadway, New York

Montreal Plant - Pepsi-Cola Company of Canada, Limited
(*Wholly-owned subsidiary*)

Havana Plant - Pepsi-Cola Company of Cuba
(*Wholly-owned subsidiary*)


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REFRESHING - ENJOYABLE
FAMOUS FOR OVER 30 YEARS
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A SPARKLING
BEVERAGE
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